SUPREME COURT, U. S.
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No. 194

In the Supreme Court of the United States

October Term, 1958

AMERICAN BEMBERG CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinion of the District Court (Pet. 5a-21a) is reported at 150 F. Supp. 355. The opinion of the Court of Appeals (Pet. 1a-5a) is reported at 253 F. 2d 691.

JURISDICTION

The judgment of the Court of Appeals was entered March 14, 1958. (Pet. 21a.) Rehearing was denied April 22, 1958. (Pet. 21a.) The petition for certiorari was filed July 21, 1958. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether, in the particular circumstances of this case, the taxpayer's originally contingent obligation to pay interest on advances made to it by its corporate common stockholders became definite and unqualified in 1939.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to

clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U.S.C. 1952 ed., Sec. 43.)

STATEMENT

American Bemberg Corporation, the taxpayer, is a Delaware corporation and on the accrual basis. Between 1925 and 1929, certain expenditures were made for its benefit by its principal voting stockholders, two German corporations, Vereinigte Glanzstoff Fabriken (referred to as Glanzstoff) and J. P. Bemberg, Actiengesellschaft (referred to as Bemberg). These German corporations, in order to make a cumulative preferred stock issue of the taxpayer attractive to the American public, guaranteed the punctual payment of semi-annual dividends on that stock from July 1, 1925, to July 1, 1929. The agreement, which was in writing, provided that the sums advanced under its terms would be repaid by the taxpayer with interest at the rate of five percent per annum. (Pet. 1a-2a.) However, the obligation to repay was qualified as follows (Pet. 2a):

> . . . and to that end, it is hereby agreed that Glanzstoff and or Bemberg shall be entitled to all accumulations of dividends upon such preferred stock which shall not have been paid by the American Corporation, and the amount of which Glanzstoff and or Bemberg have paid to the record holders of certificates for such preferred stock pursuant to said guaranty, and it is further agreed that whenever the American Corporation declares dividends on account of

any or all such accumulations of dividends, the same shall be paid to Glanzstoff and or Bemberg, provided however, that no dividends shall be declared and paid on account of any such accumulation of dividends, or reimbursement made to Glanzstoff and or Bemberg until and unless the regular dividend for the then current semi-annual period shall have been declared upon the outstanding preferred stock of the American Corporation, and a sum sufficient for the payment thereof set apart for that purpose; *nor shall any reimbursement be made to Glanzstoff and or Bemberg except out of the profits of the American Company;* . . . [Emphasis added.]

The German corporations advanced $796,250 to the taxpayer to enable it to meet its dividend obligations to preferred stockholders between 1925 and 1929. During the period 1925 to 1935, inclusive, except for the years 1928 and 1933, the taxpayer suffered annual losses. However, in each of the years from 1936 to 1940, inclusive, it earned a profit. Excluding the amount of dividends on preferred stock from 1930 to 1939, inclusive, profits as of 1939 were sufficient to enable the taxpayer to repay with interest the advances made by the German corporations.[1] (Pet. 3a.)

The taxpayer contended in both courts below that under its agreement with the German corporations its entire obligation for interest, since 1935, accrued in 1940, when, for the first time, its profits exceeded the

[1] The Court of Appeals stated that the dividends were unpaid, whereas, in fact, they were paid. (Pet. 12a, 17a.) The error is not significant for present purposes, since, in any event, the Court of Appeals was dealing with the relation of dividends, paid or unpaid, to profits.

dividends accumulated on the stock since 1930. The Commissioner, however, determined that "profits", as contemplated by the agreement, existed in 1939; that, accordingly, the prior contingent liability for interest became fixed in that year, and not in 1940. The Commissioner's determination was based on a construction of the taxpayer's contract with the two German corporations which would require the payment of interest when, in any one year, the current preferred dividend having been paid, there was an excess of income over expenses and losses—or "profits"—without reference to dividends.

The District Court agreed with the Commissioner's interpretation of the agreement (Pet. 6a-20a.), and the Court of Appeals unanimously affirmed (Pet. 1a-5a).

ARGUMENT

1. The decisions below, in holding that the petitioner could not deduct in 1940 certain originally contingent obligations for the payment of interest which had become fixed and definite prior thereto, correctly applied the well established principle that in the case of a taxpayer on the accrual basis an item of expenses is to be regarded as incurred, and hence deductible as accrued, only in the year in which the liability to pay becomes definite and absolute, whether or not presently paid or payable. *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516, 519; *Security Mills Co.* v. *Commissioner*, 321 U. S. 281, 284; *United States* v. *Anderson*, 269 U. S. 422; *Natco Corp.* v. *United States*, 240 F. 2d 398, 400 (C. A. 3).

The taxpayer does not controvert the relevance of this principle, but contends in effect that it was applied by both courts below on an erroneous factual premise. Specifically, taxpayer contended below that the term "profits" as used in its agreement with the German corporations contemplated allowance not only for the ordinary losses of a given year but also for prior dividend obligations, on which hypothesis there would not have been, until 1940, any "profits" requiring reimbursement to the German corporations. But, as the Court of Appeals observed, this construction of the agreement was an "extraordinary" one, and "plainly inconsistent" with the terms of the agreement (Pet. 4a); and as the District Court concluded, the acts of the parties to the agreement did not "indicate [that] any unusual or special meaning was to be attached to the word 'profits'" but rather "the record indicates the converse was true" (Pet. 19a). The concurrent inferences of both courts below that the parties intended to use the word "profits" in its "general meaning and usage" without regard to dividends (Pet. 4a, 20a)—consonant only with an accrual for liability for interest in 1939, and not 1940—should, in accord with usual practice, be regarded as conclusive by this Court. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

2. There is no conflict of decisions. In denying that its obligation to pay interest had accrued in 1939, the taxpayer, relying upon *Dixie Pine Co.* v. *Commissioner*, *supra*, asserted for the first time in the Court of Appeals that there was no accrual of liability in 1939 because it had resisted the claims of the German

corporations in that year. But as the decision below properly noted (Pet. 3a), the significance of the taxpayer's 1939 conduct would depend "upon the nature, the grounds and the extent and duration of its alleged resistance to the lenders' claims," and "A contention which requires such factual elaboration cannot be introduced into this case as a new matter on appeal."

Nor did such restriction constitute (Pet. 11) "a plain miscarriage of justice" within the meaning of *Hormel* v. *Helvering*, 312 U. S. 552, 558. The record does not show what form, if any, the "resistance" took in 1939, or any other fact which would have enabled the Court of Appeals to determine the extent of any contingency created thereby. In any event, even if a contingency had existed in 1939, for all the record shows it could well have continued into, and past, 1940, thereby precluding the interest deduction in the year in which taxpayer claimed it.

The taxpayer's additional contentions, (1) that the decision below erroneously defines the terms "profits" (Pet. 11-15), and (2) that it is in conflict with decisions of this Court regarding the construction of contracts (Pet. 15-16), are patently without merit. As to (1), none of the cases cited by taxpayer requires allowance for current or prior dividends in computing the profits available for distribution as dividends. Nor was there any such requirement under Delaware law. (Pet. 1a.) Delaware General Corporation Law, Sec. 35 (Delaware Revised Code (1915), Sec. 1949); 1 Delaware Code, Title 8, Sec. 170; 35 Delaware Laws, c. 85, Sec. 16; 36 Delaware Laws, c. 135, Sec. 16. See *Wittenberg* v. *Federal Mining & Smelting Co.*, 15 Del. Ch. 147, affirmed, 15 Del. Ch. 409; *Weinberg* v. *Baltimore Brick Co.*, 111 A. 2d 812 (S. Ct. Del.). As to (2), contrary to taxpayer's assertions, both the District Court and the Court of Appeals, for reasons already stated, correctly construed the contract. (Pet. 3a-4a; 18a-19a.)

CONCLUSION

The decision of the court below is correct, there are no conflicting decisions, the case turns on its particular facts, and further review is not warranted. It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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